



Date: January 29, 2021

To: Audit and Review Committee, Board of Regents  
Lonnie G. Bunch III, Secretary

Cc: Mike McCarthy, Under Secretary for Administration  
Janice Lambert, Chief Financial Officer  
Carol LeBlanc, President, Smithsonian Enterprises  
Suzanne Paletti, Controller, Smithsonian Enterprises  
Vince DeVito, Acting Director, Office of Finance and Accounting  
Porter Wilkinson, Chief of Staff to the Board of Regents  
Greg Bettwy, Chief of Staff, Office of the Secretary

From: Cathy L. Helm, Inspector General

A handwritten signature in black ink that reads "Cathy L. Helm".

Subject: *Independent Accountant's Report on the Smithsonian Enterprises Net Gain for Fiscal Year 2020 (OIG-A-21-03)*

This memorandum transmits the results of the Smithsonian Enterprise's Net Gain review for fiscal year 2020 performed by the independent public accounting firm of KPMG LLP (KPMG). On January 29, 2020, KPMG issued its independent accountants' report on the Smithsonian Enterprises Statement of Net Gain, as of September 26, 2020. KPMG concluded that no material modifications should be made to the Statement of Net Gain to be in accordance with U.S. Generally Accepted Accounting Principles.

As part of our oversight activities, we reviewed KPMG's report and documentation and interviewed its representatives. Our review of KPMG's fiscal year 2020 work disclosed no instances where KPMG did not comply, in all material respects, with the American Institute of Certified Public Accountants' Statement on Standards for Accounting and Review Services.

If you have any questions, please do not hesitate to contact me or Joan Mockeridge, Assistant Inspector General for Audits.

Attachment



**SMITHSONIAN ENTERPRISES**

Statement of Net Gain

Year ended September 26, 2020

(With Independent Accountants' Review Report Thereon)



KPMG LLP  
Suite 12000  
1801 K Street, NW  
Washington, DC 20006

## **Independent Accountants' Review Report**

Office of the Inspector General,  
Audit and Review Committee of the Board of Regents, and Secretary Bunch  
Smithsonian Institution:

We have reviewed the accompanying financial statement, which comprises the statement of net gain and the related notes to the statement of net gain of Smithsonian Enterprises, an unincorporated operating division of the Smithsonian Institution, for the year ended September 26, 2020. A review includes primarily applying analytical procedures to management's financial data and making inquiries of management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the statement of net gain as a whole. Accordingly, we do not express such an opinion.

As discussed in note 1, Smithsonian Enterprises is an unincorporated operating division of the Smithsonian Institution. The accompanying statement of net gain may not be indicative of the net gain that would have been achieved if Smithsonian Enterprises was an unaffiliated entity of the Smithsonian Institution.

### *Management's Responsibility for the Financial Statement*

Management is responsible for the preparation and fair presentation of the financial statement in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

### *Accountants' Responsibility*

Our responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statement for it to be in accordance with U.S. generally accepted accounting principles. We believe that the results of our procedures provide a reasonable basis for our conclusion.

### *Accountants' Conclusion*

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statement in order for it to be in accordance with U.S. generally accepted accounting principles.



**Other Matter**

Our review was conducted over the financial statement. The supplemental schedule of net gain by lines of business is presented for purposes of additional analysis and is not a required part of the financial statement. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statement. The information has been subjected to the limited assurance procedures applied in the review of the financial statement in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. We are not aware of material modifications that should be made to the information in the supplemental schedule in relation to the financial statement as a whole.

*KPMG LLP*

Washington, District of Columbia  
January 29, 2021

**SMITHSONIAN ENTERPRISES**

Statement of Net Gain

Year ended September 26, 2020

(Dollars in thousands)

Operating revenues, net:	
Merchandise sales	\$ 25,775
Media	35,854
Concessions, licensing, and other	31,301
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Total operating revenues, net	92,930
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Operating expenses:	
Cost of goods sold	13,223
Production costs	12,265
Circulation costs	9,833
Selling, general, and administrative costs	50,658
Depreciation and amortization	5,348
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Total operating expenses	91,327
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Net gain – operating results	1,603
Unrelated business income tax expense	141
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Net gain – operating results after taxes	1,462
Non-operating adjustment	689
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Net gain – after adjustment and taxes	\$ 2,151
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See accompanying notes to the statement of net gain and accountants' review report.

## SMITHSONIAN ENTERPRISES

Notes to Statement of Net Gain

For the year ended September 26, 2020

(Dollars in thousands)

### (1) Organization

Smithsonian Enterprises (SE) was established as an unincorporated operating division within the Smithsonian Institution (Smithsonian) in August 1999. Smithsonian was created by an act of Congress in 1846 in accordance with the terms of the will of James Smithson of England, who in 1826 bequeathed property to the United States of America “to found at Washington, under the name of the Smithsonian Institution, an establishment for the increase and diffusion of knowledge among men.” Congress established the Smithsonian as a trust of the United States and vested responsibility for its administration in the Smithsonian Board of Regents.

SE consists of various revenue producing business activities such as magazine publications, theater sales, museum stores and concessions, mail-order catalogs, product development and licensing, and supporting offices.

### (2) Summary of Significant Accounting Policies

#### (a) Basis of Presentation

Net gain is an operating measure used by management of Smithsonian and SE to assess the operating results of SE. Net gain includes all revenues and expenses related to SE’s business activities, including certain expenses allocated to SE by Smithsonian.

The statement of net gain is presented using the accrual basis of accounting. The period presented in the statement of net gain and the supporting schedule of net gain by lines of business is from September 29, 2019 through September 26, 2020 (Fiscal Year 2020). SE’s accounting year ends on the last Saturday of September.

The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Smithsonian agreed to invest in certain new strategic business initiatives and to exclude them from SE financial management reporting. During Fiscal Year 2020, there were no new investments.

#### (b) Revenue Recognition

Revenues from magazine subscriptions are deferred and recognized ratably over the subscription period. Revenues from magazine retail sales are recognized as revenue, net of estimated returns, when publications are on sale. Revenue from advertising is recognized, net of agency commissions and discounts, when publications are on sale.

Revenue from the sale of merchandise is recognized at the time merchandise is sold, net of returns and discounts. Revenue from the sale of merchandise to be sent to customers is recognized when products are shipped, net of actual/anticipated returns and discounts.

## SMITHSONIAN ENTERPRISES

Notes to Statement of Net Gain  
For the year ended September 26, 2020  
(Dollars in thousands)

Guaranteed revenues from concessions agreements are recognized ratably based on the terms of the agreement. Revenues in excess of minimum guarantees are recognized when sales are reported by concessions vendors.

Guaranteed revenues from licensing agreements for functional intellectual property are recognized upon delivery and acceptance by the licensee. Guaranteed revenue from licensing agreements for symbolic intellectual property are recognized on a straight-line basis over the license term. Royalties in excess of minimum guarantees are recognized when royalties are reported by the licensee.

Amounts received from customers and contractors in advance of revenue recognition are deferred and included in the deferred revenues account.

### **(c) *Deferred Revenues and Expense Recognition***

Revenues from subscriptions to *Smithsonian* and *Air and Space* magazines are deferred and recognized ratably over the period of the subscription, generally one year.

Promotion production and direct response advertising expenses associated with the preparation of long-lived materials, such as catalogs and campaigns to secure new subscribers are expensed as incurred. Such expenses amounted to \$8,246 for Fiscal Year 2020, and is included in production, circulation, and selling, general and administrative costs.

### **(d) *Inventories***

Inventories are reported at the lower of cost or market and consist primarily of merchandise and books. Cost is determined using the weighted average method.

### **(e) *Property and Equipment***

Property and equipment owned by Smithsonian and used by SE in its operations are allocated to SE and stated at cost. These assets are depreciated on a straight-line basis over their estimated useful lives as follows:

Buildings and improvements	30 years
Major renovations	15 years
Equipment and software	3-10 years

Leasehold improvements are amortized over the shorter of the Smithsonian lease term or their useful lives.

### **(f) *Shipping and Handling Fees and Costs***

Shipping and handling fees of \$1,000 billed to customers are included in merchandise sales. Shipping and handling cost associated with inbound freight are included in the inventory value when purchased and subsequently in Cost of Goods Sold when sold. Shipping and handling costs associated with outbound freight of \$614 related to customer orders are included in Selling, General and Administrative costs.

## SMITHSONIAN ENTERPRISES

Notes to Statement of Net Gain

For the year ended September 26, 2020

(Dollars in thousands)

### **(g) Income Taxes**

The Smithsonian is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the Code). Organizations described in that section are generally exempt from Federal income taxes, except for unrelated business income. SE's advertising sales are Smithsonian's principal source of unrelated business income.

The Tax Cuts and Jobs Act (the Act) was enacted in December 2017. Among other things, the Act imposes new taxes and establishes new rules for calculating unrelated business taxable income.

The statement of net gain includes an estimate for unrelated trade or business income tax based on the current regulatory guidance. Smithsonian will continue to evaluate the impact of the Act on current and future tax positions.

Smithsonian recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. SE does not believe the statement of net gain includes any uncertain tax positions.

### **(h) Recent Accounting Pronouncements**

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases* (Topic 842). ASU 2016-02 requires the recognition of right-of-use assets and lease liabilities by lessees for those leases classified as operating leases under the Accounting Standards Codification (ASC) Topic 840 – *Leases*. The accounting applied by the lessor under ASU 2016-02 is largely unchanged from that applied under ASC Topic 840. ASU 2016-02 is effective for the Smithsonian in fiscal year 2021.

In March 2019, the FASB issued ASU No. 2019-03, *Updating the Definition of Collections, Not-For-Profit Entities* (Topic 958). This ASU modifies the term "Collections" which in turn may change collection recognition policies and add certain disclosure requirements. ASU 2019-03 is effective for the Smithsonian in fiscal year 2021.

### **(3) Employee Benefit Plans**

Substantially all SE employees are eligible to participate in the Smithsonian's defined-contribution retirement plan. Under the plan, Smithsonian contributes specified percentages of employees' salaries to purchase individual annuities, the rights to which are immediately vested with the employees. Employees can make voluntary contributions, subject to certain limitations. During Fiscal Year 2020, SE's contribution expense under this plan amounted to \$3,061.

### **(4) Commitments and Contingencies**

#### **(a) Food Services Agreement**

Under an agreement expiring in March 2026, a third party agreed to assist in the design, construction, and operation of food services at several Smithsonian museums and provided \$7,250 to fund capital improvements for the Food & Beverage Operations in the museums. The capital improvement projects selected are at the discretion of Smithsonian. The funding is recognized over the term of the agreement. Should the agreement be terminated, the agreement provides for the repayment of the

## SMITHSONIAN ENTERPRISES

Notes to Statement of Net Gain  
For the year ended September 26, 2020  
(Dollars in thousands)

capital improvement costs based on the passage of time. Revenue recognized under the agreement in fiscal year 2020 was \$2,543 and is classified as Concessions Revenue.

The third party also agreed to pay an annual fixed fee of \$100 over the term of the agreement. Due to the COVID-19 pandemic and museums closures from mid-March 2020 through September 2020, the fee was recorded for \$50 as Revenue for this time period.

### **(b) Outsourcing Agreements**

SE subcontracts infrastructure, transaction management services and systems support for its catalog business with fees based on services performed. Total fees paid for such services in Fiscal Year 2020 amounted to \$1,170 and are included in selling, general and administrative costs.

SE also subcontracts fulfillment services for its magazine circulation with fees based on the quantity of circulation. Such fees amounted to \$1,509 during Fiscal Year 2020 and are included in circulation costs.

During fiscal year 2020, SE engaged a third party to operate a distribution center for all merchandise sold in SE museum stores. Fees vary based on the actual functions and transactions completed by the vendor and amounted to \$491 during Fiscal Year 2020. Such fees are included in selling, general and administrative costs.

### **(5) COVID Pandemic**

Certain external events, such as pandemics, natural disasters, severe weather, technological emergencies, riots, acts of war or terrorism or other circumstances, could potentially disrupt the Smithsonian's ability to conduct its business. A prolonged disruption in the Smithsonian Enterprises operations could have an adverse effect on SE's financial condition and results of operations.

One such external event is the recent global outbreak of the novel coronavirus (COVID-19), a respiratory disease declared to be a pandemic (Pandemic) by the World Health Organization, which is affecting the national capital markets and the national economy, and the museum, research and education sectors. The threat from the Pandemic is being addressed on the national, federal, state and local levels in various forms, including executive orders, state and local orders, and legislative actions.

On March 13, 2020, the President of the United States declared a national emergency with respect to the Pandemic. The Smithsonian's museums and galleries in the District of Columbia and New York and the Smithsonian's National Zoo were closed in March 2020 to support the effort to contain the spread of COVID-19. Select museums, galleries, and the National Zoo were reopened in a phased approach over the summer. However due to the resurgence of COVID-19, they were closed again in November 2020. Adverse consequences of the Pandemic specific to the SE's activities, included but were not limited to, declines in revenues from retail, concessions, and parking operations; special events held at Smithsonian facilities; and Smithsonian programs that involve travel. This also resulted in Retail Staff furloughs and the inability to utilize intermittent employees. These cutbacks are reflected in the statement of net gain.

**SMITHSONIAN ENTERPRISES**

Notes to Statement of Net Gain  
For the year ended September 26, 2020  
(Dollars in thousands)

**(6) Subsequent Events**

Management has evaluated subsequent events from September 27, 2020 through January 29, 2021, which is the date that the statement of net gain is available to be issued and determined that there are no adjustments to or other items to disclose.

**SMITHSONIAN ENTERPRISES**

Supplemental Schedule – Schedule of Net Gain by Lines of Business

Year ended September 26, 2020

(Dollars in thousands)

	<b>Museum Services</b>	<b>Retail/ Direct</b>	<b>Media</b>	<b>Travel</b>	<b>Corporate</b>	<b>Total</b>
Operating revenues, net:						
Merchandise sales	\$ —	25,075	700	—	—	25,775
Media	—	(11)	35,865	—	—	35,854
Concessions, licensing, and other	7,349	7,507	10,229	3,497	2,719	31,301
Total operating revenues, net	<u>7,349</u>	<u>32,571</u>	<u>46,794</u>	<u>3,497</u>	<u>2,719</u>	<u>92,930</u>
Operating expenses:						
Cost of goods sold	—	11,861	217	523	622	13,223
Production costs	—	1,666	10,270	329	—	12,265
Circulation costs	—	67	9,573	193	—	9,833
Selling, general, and administrative costs	3,225	23,579	13,255	2,512	8,087	50,658
Depreciation and amortization	2,049	1,297	144	10	1,848	5,348
Total operating expenses	<u>5,274</u>	<u>38,470</u>	<u>33,459</u>	<u>3,567</u>	<u>10,557</u>	<u>91,327</u>
Net gain – operating results	2,075	(5,899)	13,335	(70)	(7,838)	1,603
Unrelated business income taxes	—	—	123	18	—	141
Net gain – operating results after taxes	2,075	(5,899)	13,212	(88)	(7,838)	1,462
Non-operating adjustment	—	380	28	24	257	689
Net gain – after adjustment and taxes	<u>\$ 2,075</u>	<u>(5,519)</u>	<u>13,240</u>	<u>(64)</u>	<u>(7,581)</u>	<u>2,151</u>